UNITED STATES DISTRICT COURT
DISTRICT OF NEVADA

SECURITIES AND EXCHANGE COMMISSION
Plaintiff,
VS.
H. THOMAS FEHN, ET AL,
Defendants

BY JULIE RIVERA
CV-S-92-946-HDM(RLH)
FINDINGS OF FACT AND CONCLUSIONS OF LAW
AND FINAL JUDGMENT AND ORDER OF PERMANENT INJUNCTION

This is an action for a permanent injunction brought by the plaintiff, Securities and Exchange Commission ("S.E.C.") against H. Thomas Fehn. Plaintiff seeks the entry of a permanent injunction pursuant to Sections 20(b) of the Securities Act of 1933 ("Securities Act"), 15 U.S.C. § 77t(b), and Sections 21(d) and (e) of the Securities Exchange Act of 1934 ("Exchange Act") 15 U.S.C. §§ 78u(d) and (e).

The defendant Fehn ("Fehn"), an attorney, is charged with aiding and abetting violations of the federal Securities Laws by CTI Technical, Inc. ("CTI") and Edwin "Bud" Wheeler ("Bud Wheeler"). The Plaintiff alleges that Fehn aided and abetted the violations by CTI and Bud wheeler of the anti-fraud and reporting provisions of the federal Securities Laws contained in sections 10(b) and 15(d) and 23(a) of the Exchange Act 15 U.S.C. §§ 78j(b), 78o(d) and 78w(a) and rules promulgated thereunder Rules 10-5, 15d-13 and 12b-20 [17 C.F.R. § 240 10b-5, 15d-13 and 12b-20] by drafting and filing with the commission periodic reports on behalf of CTI which he knew, or was reckless in not knowing, were false and misleading.

Fehn contends that there was no primary violation of the Exchange Act by either Wheeler or CTI in connection with the filing of CTI's periodic reports. He argues that the information that plaintiff contends was omitted from those reports was either not required to be included in the reports by any law or regulation of the S.E.C., or it was not material at the time the reports were filed; and if CTI and Wheeler were required, by law or regulation, to disclose in the periodic reports that there had been a prior violation of law by them (in connection with CTI's initial public offering ("IPO"), that such law or regulation would be an unconstitutional violation of their Fifth Amendment rights against self-incrimination.

Finally, Fehn argues that since there was no violation of the law by Wheeler and CTI in connection with the filing of periodic reports, he, Fehn, cannot be liable as an aider or abetter.

This Court has jurisdiction over this action pursuant to section 22(a) of the Securities Act [15 U.S.C. § 77u(a)] and Sections 21(e) and 27 of the Exchange Act (15 U.S.C. §§ 78u(e) and 78aa.

The following facts are admitted by the parties and required no further proof:

A. DEFENDANT FEHN

1. The Commission, pursuant to the authority granted to it by Sections 10(b), 15(d) and 23(a) of the Exchange Act [15 U.S.C. §§ 78j(b), 78o(d) and 78w(a)], has promulgated rules 10b-5, 12b-20 and 15d-13 [17 C.F.R. §§ 240.10b-5, 240.12b-20 and 240.15d-13], which were in effect at all times relevant to this Complaint and which are still in effect.

2. In connection with the transactions, act, practices, and course of business described in this Complaint, the defendant, directly and indirectly, has made use of the means and instrumentalities of interstate commerce, of the mails, and of the means and instrumentalities of transportation and communication in interstate commerce.

3. Certain of the transactions, acts, practices and courses of business constituting the violations of law alleged herein occurred within this judicial district.

4. Defendant Fehn resides in Los Angeles, California. He is licensed to practice law in California by the Supreme Court of the State of California. Fehn participated in the drafting and preparation of three periodic reports on Forms 10-Q for CTI, and further participated in filing the periodic reports on Forms 10-Q with the plaintiff Commission. The CTI quarterly report for the period ended March 31, 1988, was filed in or about August 1988. The CTI quarterly reports for the periods ending December 31, 1987 and June 30, 1988, were filed in or about November 1988.

5. CTI was incorporated in Nevada in January 1987. Its last know principal office was located at 3900 Paradise Road, Las Vegas, Nevada. In connection with its blind pool initial public offering, in or about June 1987, CTI filed its initial Registration Statement on Form S-18 with the plaintiff Commission to register 20,000,000 securities units. Each securities unit consisted of one share of common stock and nine detachable warrants to purchase additional shares of common stock for three cents per share. This Registration Statement related to a self-underwritten (i.e. not involving an underwriter) offering by CTI. This Registration Statement went effective on August 24, 1987. In or about August 1987, CTI filed a second

Registration Statement on Form S-18 with the plaintiff Commission which was substantially identical to the June 1987 Registration Statement except that it disclosed the appointment of Stoneridge Securities, Inc. ("Stoneridge") as underwriter and sought to register a total of 22,000,000 securities units, 2,000,000 of which were to be issued to Stoneridge as compensation. The August Registration Statement on Form S-18 became effective on September 23, 1987. CTI common stock and warrants were publicly quoted in the National Daily Quotations Service's "Pink Sheet."

6. On September 29, 1987, the initial distribution of CTI units was completed.

7. The proceeds from the CTI initial public offering were wire transferred from Ameritrade, Inc., the clearing firm for Stoneridge Securities, Inc., to the CTI escrow account at Continental National Bank, Las Vegas, Nevada, account number 0102022704. Michelle Brazier opened the account at Continental National Bank.

8. Beginning on September 29, 1987, Ms. Brazier issued checks drawn on the escrow account including: $26,000 to Stoneridge Securities, Inc.; $30,000 to American Development & Management Co.; $5,000 to Continental National Bank and the remaining $139, 000 of the CTI Technical, Inc. offering proceeds to Bud Wheeler.

9. Bud Wheeler deposited the $139,000 in offering proceeds in CTI's account at the Continental National Bank, Las Vegas, Nevada account number 102025371. Signatories on the account were Jennie Orrell, mother of Bud Wheeler, and Kent Midby (Midby).

10. In October through December of 1987, CTI issued checks drawn on account number 102025371 including: checks in excess of $118, 000 directly to, or on behalf of American Development & Management Co. Those checks were signed by Jennie Orrell.

11. American Development and Management Co. was a company owned and controlled by Bud Wheeler. Bud Wheeler also owned and controlled Desert T.V. and Appliance and UMK Consolidated Investors.

12. Bud Wheeler is a resident of Las Vegas, Nevada. Bud Wheeler was the promoter behind CTI and was responsible for its incorporation in January 1987.

13. From January 1987 to August 1988, the date that Bud Wheeler's election as president of CTI was first disclosed publicly, Bud Wheeler had no publicly disclosed affiliation as an officer, director, shareholder, founder or control person of CTI.

14. Ronald D. Wheeler ("Ron Wheeler") is a resident of Las Vegas, Nevada. Ron Wheeler and Bud Wheeler are brothers. Ron Wheeler was the founder and president of Stoneridge until it ceased operations in February of 1988.

15. During the period from at least September 1987 through all time relevant, Fehn served as counsel to Stoneridge Securities, Inc., the underwriter for CTI's initial public offering of securities units. Fehn, in his capacity as counsel for Stoneridge, reviewed the CTI Registration Statement on Form S-18 and knew of the representations contained therein.

16. In or about October or November 1987, Fehn knew that CTI's Registration Statement had become effective, that CTI's securities units had not been registered for sale in any state, and that purchases and sales of CTI's securities units, consisting of common

stock and warrants, had occurred in states in which they had not been registered for sale (i.e. that the offering had not been "blue skyed"). Fehn also knew, in October or November of 1987, that rescission by CTI was not possible because the offering proceeds had been spent.

17. In November 1987, Fehn became counsel for CTI, Bud Wheeler and others, in connection with a private investigation conducted by the plaintiff commission to determine whether CTI and others had violated the federal Securities Laws. Fehn also represented Stoneridge Securities, Inc. and its officers and certain employees. In connection with his representation of CTI, its officers, directors, employees and agents, and Stoneridge Securities, Fehn was present when the following persons testified, under oath, to the staff of the Commission: Marnell Binkley, C. Donald Dorsey, Brenda Kross, Midby, Timothy B. Mobley, Bud Wheeler, Ron Wheeler, and Ronald D. Wheeler, Jr.,

18. Fehn is 50 years old

19. Fehn was admitted to the bar in 1969.

20. Fehn has given securities law seminars.

21. Fehn's practice has always been concentrated in securities related matters.

The following facts, though not admitted, will not be contested at trial evidence to the contrary:

A. DEFENDANT FEHN

1. On September 18, 1989, in *Securities and Exchange Commission v. Stoneridge Securities, et al.*, the United States District Court for the District of Nevada entered a Final Judgment of Permanent Injunction, with Findings of Fact and Conclusions of Law, against CTI finding that it had violated the federal Securities Laws and enjoining it from, among other things, further violations of Sections 5(b), 6 and 17 (a) of the Securities Act [15 U.S.C. § 77e(b), 77f and 77q(a)] and Sections 10(b) and 15(d) of the Exchange Act (15 U.S.C. §§ 78j(b) and 78o, (d)] and Rules 10b-5, 12b-20, 15d-1, 15d-11 and 15d-13 thereunder (17 C.F.R. §§ 240.10b-5, 240.12b-20, 240.15d-1, 240.15d-11 and 240.15d-13].

2. On September 18, 1989, in *Securities and Exchange Commission v. Stoneridge Securities, et al.*, the United States District Court for the District of Nevada entered a Final Judgment and Permanent Injunction, with Findings of Fact and Conclusions of Law, against Bud Wheeler finding that he had violated the federal Securities Laws and enjoining him from, among other things, further violations of Sections 5(b), 6 and 17(a) of the Securities Act [15 U.S.C. §§ 77e(b), 77f and 77q(a)] and Sections 10(b) of the Exchange Act [15 U.S.C. §§ 78j(b)] and Rule 10b-5, thereunder [17 C.F.R. § 240.10b-5], and from aiding and abetting violations of Sections 15(d) of the Exchange [15 U.S.C. § 78o(d)] and Rules 15d-1, 15d-11 and 15d-13 thereunder [17 C.F.R. §§ 240.15d-1, 240.15d-11 and 240.15d-13].

3. On September 23, 1992, Bud Wheeler was indicted on one count of securities fraud in connection with his role in the fraudulent initial public offering of CTI Technical, Inc. That indictment charged that Bud Wheeler controlled CTI and engaged in a scheme to defraud purchasers of CTI securities. That indictment also charged that the CTI Registration Statement, among other things, failed to disclose the figurehead role of the named officers and directors of CTI and failed to disclose that Bud Wheeler actually controlled CTI. On May 18, 1993, Bud Wheeler was convicted for his criminal violation of Section 17(a) of the Securities Act of 1933. In July 1993, Bud Wheeler was sentenced to 18 months in prison.

At trial, before this Court plaintiff proved:

1. Prior to the filing of the CTI quarterly reports Fehn had actual knowledge, among other things, that Bud Wheeler was the undisclosed promoter and control person of CTI, that the purported officers and directors were mere figureheads who had not capitalized the company, and they had not approved the various corporate acts of CTI, had not signed the Registration Statement and that Bud Wheeler controlled the CTI offering proceeds. None of these facts were disclosed in the CTI Form 10-Qs which Fehn assisted in preparing and which he filed with the Commission.

2. Prior to the filing of the CTI quarterly reports, Fehn also had knowledge, through the inventory records of Stoneridge which were identified by his client, Timothy Mobley, an assistant trader at Stoneridge Securities, of the plan of Bud Wheeler and Stoneridge to offer CTI units consisting of one share of CTI common stock and nine warrants to purchase CTI common stock for 1 cent per unit, immediately

purchase the units back for 2 cents per unit, strip the warrants from the units to keep for themselves and resell the shares of CTI common stock only to the public for 4 cents per share.

3. The stock of CTI was traded before and after the filing, by Fehn an behalf of CTI, of the three CTI quarterly reports on Forms 10-Q.

4. Fehn admits that he was aware that the three CTI quarterly reports on Forms 10-Qs, which he substantially assisted in drafting, editing, reviewing, revising and filing, were incomplete and did not contain all the information necessary to make the statements made not misleading.

5. Fehn's firm has done substantial work in the registration area of Securities Laws and the filing of quarterly and annual reports by public companies and intends to continue doing such work.

TRIAL TESTIMONY

Defendant Fehn, admitted at trial that he first became aware during the S.E.C. investigative hearing that his client CTI had not filed required form 10-Q quarterly reports with the Commission.[1] He also testified that counsel for the

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[1] Rule 15d-13 provides impertinent part:

(a) ... every issuer that has securities registered pursuant to the Securities Act of 1933 is required to file annual reports pursuant to section 15(d) of the Securities Exchange Act of 1934 on Form 10-K ... shall file a quarterly report on Form 10-Q for each of the first three quarters of each fiscal year of the issuer, commencing with ... the first fiscal quarter reported upon in the registration statement. ...

Section 15(d) of the Exchange Act provides, in pertinent part:

(d) ... issuer which shall ... file a Registration Statement which has become effective pursuant to the Securities Act of 1933, as amended, shall file with the Commission, in accordance with

S.E.C., Gregory F. Von Shaumberg, had discussed with him during a recess in the investigative hearings the necessity for filing the quarterly reports. This conversation was on June 20, 1988 when, Fehn testified, he first learned that the Food and Drug Administration had banned the sale of "a patch to control weight" which was the principle product of CTI.

Fehn testified he told Mr. Von Shaumberg that he, Fehn, would see that the 10-Qs were filed. He then had a conference with Bud Wheeler and told him the failure to file 10-Qs was a "disclosure problem." Wheeler said he knew nothing about such forms. Fehn then explained the process to Wheeler and gave Wheeler S.E.C. booklets concerning the filings.

Around the end of July 1988 Wheeler brought Fehn a 10-Q form for the period ending March 31, 1988. The witness testified he read it and discussed matters that should be disclosed with Wheeler. Wheeler stated he had no interest in disclosing any information.

Fehn, testified he believed Wheeler had criminal exposure and he advised Wheeler to take the Fifth Amendment. Fehn, stated that even though he then knew the Registration Statement failed to disclose Wheeler's role in CTI, he believed that under the holding of *U.S. Matthews*, 787 F.2d 38 (2nd Cir. 1986), compelling disclosure of an uncharged

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> such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors, such supplementary and periodic information, documents, and reports as may be required pursuant to section 13 of this title in respect of a security registered pursuant to section 12 of this title. . . .

CTI registered its securities for sale under the Securities Act of 1933 by the filing with the Commission its Registration Statements on Form S-18. Accordingly, CTI was required to file periodic reports for the first three quarters following its initial public offering on Form 10-Q, as provided by Section 13 of the Exchange Act and the rules thereunder.

violation of the law would violate his clients' Fifth Amendment rights and in any event the question of whether a '33 Act violation (failure to disclose Wheeler's role in the Registration Statement) must be disclosed in '34 Act reports (the 10-Qs) is indeed an legal requirement.

Counsel argued that if Fehn reasonably believed at the time the 10-Q reports were filed that the failure to disclose a material fact in the Registration Statement need not be disclosed in the 10-Q report, Fehn could not have had knowledge of the primary violation and thus, could not have aided and abetted it.

DISCUSSION

Counsel stated in his memorandum of Points and Authorities in opposition to plaintiff's Motion for Summary Judgment (Document #31) at p. 4:

> . . . . plaintiff contends that there was a legally recognizable duty on CTI to disclose in its '34 Act periodic reports the '33 Act violations which had previously been committed. Plaintiff cites no support for this proposition other than its own conclusory pleading. If there is no such requirement for CTI to disclose its '33 Act violations, then no primary violation of the '34 Act has occurred. If no violation exists, no aiding and abetting liability can follow. . . . Moreover, even if there were a requirement to disclose an uncharged prior violation of the law, such a requirement would violate the constitutional privilege against self-incrimination. (*See U.S. v. Matthews*, 787 F.2d 38 (2nd Cir. 1986).

This opinion will consider first, whether there is a legally cognizable duty to disclose in a 10-Q report a misleading statement made in the corporation Registration Statement, then we will discuss the applicability of *U.S. v. Matthews* to the Fifth Amendment assertion of Wheeler and CTI.

I.

Duty to Disclose

The intent of Congress in enacting the 1934 Exchange Act was to establish a Commission with rule making powers to monitor participants in the equity securities markets. In keeping with the self-regulating nature of market participants, Congress enacted 15 U.S.C. § 78j(b) and the Commission promulgated thereunder Rule 10b-5 (17 C.F.R. § 240 10b-5). Rule 10b-5. as it is customarily called, is straight forward in its command. It states in pertinent part:

It shall be unlawful for any person directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails . . . .

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person in connection with the sale of any security.

The complaint in this action charges in Count V:

During the period from at least August 1988, CTI violated Section 15 (d) of the Exchange Act and Rule 15d-13 thereunder by filing with the plaintiff Commission periodic reports on forms 10-Q for the quarters ended December 31, 1987, March 31, 1988 and June 30, 1988 which contained untrue statements of material fact and omitted to state material facts, necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading . . . .

The complaint alleges in substance that in connection with the offer, purchase and sale of securities units, common stocks and warrants of CTI, Bud Wheeler devised a scheme to defraud by organizing, incorporating, and administering the affairs of CTI in connection with the public offering of its securities.

The scheme described is the filing of Registration Statements on forms S-18 with the Commission. The Registration Statements were distributed to investors, prospective investors and the general public. The Registration Statements, it is charged, omitted to state the role of Bud Wheeler in the formation and management of CTI, the role of the other officers and directors in management; and the source of the initial capitalization of CTI.

The Complaint alleges that defendant Fehn, as counsel to CTI, its officers and directors knew of the material omissions and misstatements in the Registration Statements. In August 1988, Fehn substantially assisted Bud Wheeler's and CTI's preparation and filing with the Commission and public dissemination of a periodic report on form 10-Q for the quarter ended March 31, 1988. That report omitted to state the roles of Bud Wheeler, the directors and the officers in the formation and management of CTI, Wheeler's control over the common stock and warrants of CTI, and the material contingent liabilities of CTI. The complaint also alleges the same participation by defendant Fehn and the same deficiencies in forms 10-Q submitted in November 1988, for the quarters ending December 31, 1987 and June 30, 1988.

It is difficult for this Court to credibly accept defendant's argument that the forms 10-Q did not legally require that the omissions and misstatements made in the Registration Statement, of which he was aware, be corrected. This is especially difficult in light of Mr. Fehn's testimony that he has been an attorney since 1969, his firm has done substan-

tial work in the registration area of Securities Law; his primary practice is in the field of Securities Law and he is recognized as an expert in the area in that he conducts seminars on Securities Law.

Section 15(d) [15 U.S.C. 78o(d)] of the Exchange Act requires that public companies file periodic reports in accordance with Commission rules and regulations.

Rule 12b-20 [17 C.F.R. 240 12b-20] promulgated pursuant to section 15(d) provides:

> In addition to the information expressly required to be included in a statement or report, there shall be added such further material information, if any, as may be necessary to make the required statements, in the light of the circumstances under which they are made not misleading.

Rule 10b-5, cited above, makes it unlawful to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading.

The Ninth Circuit has recognized the applicability of Rule 10b-5 to S.E.C. reporting requirements in *Hanon v. Dataproducts Corp.*, 976 F.2d 497 (9th Cir. 1992). The *Hanon* court first cited the general rule:

> [A]n issuer's public statements cannot be analyzed in complete isolation, *In re Convergent Technologies v. S.E.C. Litig*, 948 F.2d 507, 512 (9th Cir. 1991). In order to survive summary judgment, Hanon must demonstrate that a particular statement, when read in light of all the information then available to the market, or a failure to disclose particular information, conveyed a false or misleading impression. *Id.*[2]

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[2] *Hanon v. Dataproducts Corp.*, 976 F.2d 501.

In response to the company's claim that it was not required to disclose in its annual report (10-K) technical problems with its product the Court stated:

> We reject this argument. Denigrating or not, Rule 10b-5 imposes a duty to disclose material facts that are necessary to make disclosed statements, whether mandatory or volunteered not misleading *See* 17 C.F.R. § 240 10b-5.[3]

Reading the statute and rules together it is inescapable that a person who files a required report (Form 10-Q] and at the time of reporting has knowledge that the required Registration Statement [Form S-18] omits information specifically required to be reported[4] and for the first time mentions the name of Bud Wheeler (the promoter) as a person recently elected as Chief Executive Officer of and former consultant to the corporation[5] without disclosing that

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[3] *Id.* at p. 504.

[4] Item 15 of Form S-18 required the following information to be included in CTI's registration statement:

Section 15(d):

(a) State the names of the promoters, the nature and amount of anything of value (including money, property, contracts, options or rights of any kind) received or to be received by each promoter directly or indirectly from the registrant, and the nature and amount of any assets, services or other consideration therefor received or to be received by the registrant. The term "promoter" is defined in Rule 405 under the Act.

Rule 405 of Regulation C [17 C.F.R. 230.405] defines promoter as, among other things, "[a]ny person who, acting alone or in conjunction with one or more other persons, directly or indirectly takes initiative in founding and organizing the business or enterprise of an issuer . . ." Bud Wheeler was a promoter of CTI.

[5] Form 10-Q paragraph 5 for the period ending March 1988 stated:

On February 1, 1988, Edwin "Bud" Wheeler was named Chief Executive Officer of the company. Bud Wheeler is also the president of a management and development firm who performed consulting services to the company.

Wheeler's role as promotor was omitted from the Registration Statement, has failed to comply with Rules 10b-5 and 12b-20. Both of these rules require that, one making a required report shall add such further material information as may be necessary to make the former required statements not misleading. Implicit in the requirement to file periodic reports and explicit in the rules is the notion that the information, when filed, be correct. If it was not correct when filed, then to prevent misleading investors, the incorrect information must be corrected in a subsequent required report. I find that the March 31, 1988 10-Q is misleading when it implies that Wheeler performed consulting services to the company when Fehn, at that time knew that Wheeler was the organizer, promoter and controller of the company.[6]

The Supreme Court "repeatedly has described the fundamental purpose of the [Exchange] Act as implementing a philosophy of full disclosure . . ." *Santa Fe industries, Inc. v. Green*, 430 U.S. 462, 477-488 (1977). Provided with full and honest disclosure, investors and prospective investors can make informed decisions regarding securities.

In this case the fraud on the market occurred because the false and misleading Registration Statement was the only public information available in the market place in which CTI was being traded during the approximate nine months between the CTI initial public offering and the filing of the March 31, 1988 from 10-Q. *Basic v. Levinson*, 485 U.S. 224 (1988).

This Court finds that the full disclosure scheme of the Securities Laws required Fehn, as counsel to CTI to inform the investing public in the March 1988 10-Q of the informa-

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[6]Although this opinion focuses on the failure of Fehn to disclose Wheeler's actual role in the corporation in the form 10-Q, the opinion is equally applicable to other failures to disclose, of which Fehn was aware at the time he assisted in the preparation and filing of the reports.

tion he then had concerning the role of Bud Wheeler and not mislead the investors by describing Wheeler as a former consultant. In substantially assisting in the filing of a required document that failed to adequately describe Wheeler, Fehn aided and abetted CTI in violating the anti-fraud and reporting regulations of the S.E.C.

In order to find liability for aiding and abetting under Section 17(a) of the Securities Act or Section 10(b) of the Exchange Act and rule 10b-5 thereunder the plaintiff must prove the following three elements:

1. The existence of an independent primary wrong;

2. Actual knowledge by the alleged aider and abettor of the wrong; and

3. Substantial assistance by the aider and abettor in the wrong. *Newton v. Univest Financial Corp.*, 802 F. Supp. 346 (D. Nev. 1990). *Durham v. Kelly*, 810 F.2d 1500, 1505 (9th Cir. 1987).

1.

The Existence of an Independent Primary Wrong

This element has been proven by a preponderance of the evidence. Plaintiff has introduced evidence of the testimony of the members of the Board of Directors of CTI given during the S.E.C. investigative hearings; the final judgments of permanent injunction against CTI and Bud Wheeler in this Court on September 18, 1989; the certificate of conviction of Bud Wheeler based on one count of securities fraud in connection with his role in the fraudulent initial public offering of CTI and facts admitted by the parties in the Pretrial Order set forth in paragraph 5 through 13 recited above at pp. 3-6.

2.

Actual Knowledge by the Alleged
Aider and Abettor of the Wrong

This element has been proven by a preponderance of the evidence through the trial testimony of Mr. Fehn;[7] his admission of uncontested facts 15 through 17 recited in the Pre-trial Order and set forth above at pp. 6-7 and the testimony of the officers and agents of CTI given at the S.E.C. investigative hearings when Fehn was present.

3.

Substantial Assistance by the
Aider and Abettor In the Wrong

This element has been proven by a preponderance of evidence through the testimony of Fehn at trial and the admission of uncontested fact 4 recited in the Pre-trial Order and set forth above at p. 3.

The conclusion that Fehn aided and abetted violations of the Securities Laws by Wheeler and CTI are based upon the following findings of fact:

1. When CTI filed its Registration Statements with the Commission no mention was made therein of the fact that Wheeler was the promoter, organizer and operator of all the corporations significant activities. Fehn as attorney for the underwriter had reviewed this document and is charged with knowledge that Wheeler was not mentioned. This omission, though

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[7] "When a lawyer . . . concludes that his client's disclosures are not adequate to comply with the law and so advises his client, he is "aware" in a literal sense, of a continuing violations of the securities laws." *In Re Carter*, S.E.C. Release No. 34-17597. Adm. Proc. File No. 3-5464, February 28, 1981 at p. 84, 171. Fehn testified he advised Wheeler that he had disclosure problems.

not attributable to Fehn, was a violation of Rule 240 10b-5 and;

2. Fehn, knowing of the activities of Wheeler and knowing they were not revealed in the Registration Statements, substantially assisted in the preparation of the March 31, 1988, June 31, 1988 and September 31, 1988 10-Q reports which failed to correct the omission in the Registration Statement.

3. Fehn, as an attorney practicing in the field of securities law knew or closed his eyes to that which should have been obvious to a professional of his experience,[8] that neither Wheeler or CTI had a Fifth Amendment privilege to resist disclosure of Wheeler's activities, yet he advised his clients of such privilege and substantially aided in preparing and filing misleading reports with the Commission.

II.

Are the Disclosure Requirements Violations of the Fifth Amendment?

Defendant Fehn, testified that he advised Wheeler that he could resist disclosure because of the Fifth Amendment privilege. Defendant relies heavily on *U.S. v. Matthews*, 787 F.2d 38 (2nd Cir. 1986). Certain important distinctions must be made. Fehn represented not only Bud Wheeler but the corporation CTI. Although it is undoubtedly true that an individual can, under proper circumstances, invoke the Fifth Amendment privilege, *Curcio v. United States*, 354, U.S. 118 (1957), a corporation, even a single stockholder corporation, cannot invoke the Fifth Amendment *United States v.*

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[8] *Spectrum Financial Cos. v. Marconsult. Inc.*, 608 F.2d 377, 381 (9th Cir. 1979); *Nelson v. O. E. Servwold*, 576 F.2d, 332, 1338 (9th Cir.) *cert denied*, 439 U.S. 970 (1978).

Richardson, 469 F.2d 349 (10th Cir. 1972); *Wilson v. United States*, 221 U.S. 361 (1911). It is to be remembered that the defendant Fehn was engaged in filing the CTI quarterly reports and as to CTI there was no privilege against self-incrimination.

Fehn's reliance on *U.S. v. Matthews* is misplaced, *Matthews* was a criminal case involving the disclosure requirements of Section 14(a) of the Exchange Act in which it was charged that Matthews, a candidate for re-election to the Board of Directors of a corporation, failed to reveal in his proxy statement an uncharged prior violation of the law.

The Circuit in *Matthews* takes great pains to set forth certain principles. First, it is noted, that Congress delegated to the S.E.C. the primary responsibility for seeing to the enforcement of the federal Securities Laws. The congressional intention was to give the Commission complete discretion to require in corporate reports only such information as the S.E.C. deems necessary or appropriate in the public interest to protect investors. The Court then turned to the Commission's rules to determine what disclosures were required in Proxy Statements. It noted that the Commission adopted a rule providing for disclosure only of criminal convictions or pending criminal proceedings in Proxy Statements concerning a corporate candidate's integrity. The Court cited to *GAF Corp v. Heyman*, 724 F.2d 727, 740 (2nd Cir. 1983) in which it emphasized that the Commissions's rules do not require a candidate for election to accuse himself of antisocial or illegal activities and noted that the Ninth Circuit is in accord, *Gaines v. Haughton*, 645 F.2d 761, 779 (9th Cir. 1981), *cert denied.*, 454 U.S. 1145 (1982). The Court concluded that uncharged prior misconduct was not material or otherwise not within the ambit of federal Securities Laws with one important *caveat*, so long as the uncharged criminal conduct *is not required to be disclosed* [Emphasis mine) by any rule lawfully promul-

gated by the S.E.C.[9] This observation should have alerted Mr. Fehn that he was dealing with a situation specifically excepted by the Court from the *Matthews* rule.

As this Court has written in Part I of this opinion, the specific rules of the S.E.C. require corporations dealing in securities offered to the public to file Registration Statements and Quarterly Reports. Such required filings have been termed by Courts dealing with such documents and a claim of Fifth Amendment privilege as "The Required Documents Rule."

This rule may be simply stated: it arises in the context of a person who invokes the privilege of self incrimination as a defense to complying with a requirement, imposed by law, to furnish certain information, either in testimony or documents. The invocation of the privilege in this context requires an inquiry into whether the public need for the information outweighs "the individual claim to constitutional protection." *California v. Byers*, 402 U.S. 424, 427 (1971). It depends on the facts in each case whether the privilege is sustained or rejected, however there is a common thread running through the cases. Where the compulsion to produce is bottomed in a legal requirement to disclose there is no Fifth Amendment privilege to assert. The application of this rule was most recently discussed by the Supreme Court in *Baltimore City Department of Social Services v. Bouknight*, 493 U.S. 549 (1990) in which the Court observed that the fact that the requirement to produce will compel testimonial assertions that may prove incriminating,

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[9] "At least so long as uncharged criminal conduct is not required to be disclosed by any rule lawfully promulgated by the Securities Exchange Commission, nondisclosure of such conduct cannot be the basis of a criminal prosecution" *United States v. Matthews*, 787 F.2d at p.1.

does not, in all contexts, justify invoking the privilege. The Court explained:

> The Court has on several occasions recognized that the Fifth Amendment privilege may not be invoked to resist compliance with a regulatory scheme construed to effect the State's public purposes unrelated to the enforcement of its criminal laws. . . . No Fifth Amendment protection attached to production of the 'required records,' which the defendant was required to keep, not for his private uses, but for the benefit of the public, and for public inspection."[10]

The Court quoted *Wilson v. United States*, 221 U.S. 361, 382 (1911) for the rationale behind the required records exception:

> [W]here by virtue of their character and the rules of law applicable to them, the books and papers are held subject to examination by the demanding authority, the custodian has no privilege to refuse production although their contents tend to criminate him. In assuming their custody he has accepted the incident obligation to permit inspection.

There can be no question that the regulatory scheme of the S.E.C. is non-criminal in nature. The record keeping and reporting regulations were enacted for the purpose of protecting public investors participating in the securities markets. Wheeler, Chief Executive Officer of CTI and custodian of its books and records, had no Fifth Amendment privilege to refuse disclosure in the quarterly reports of his activities revealed in those books and records of the corporation, even though those activities would incriminate him. The defendant Fehn, acting as an attorney for CTI and Wheeler, had no legal basis to advise Wheeler that he could invoke the privilege and resist disclosure. When Fehn, with

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[10]493 U.S. at p. 556.

knowledge of Wheeler's activities, assisted in the preparation and filing of the quarterly reports, without revealing Wheeler's activities he aided and abetted Wheeler and CTI in violating rules 240 10b-5, 12b-20 and 15d-13.

III.

Injunction

Plaintiff moves for a Permanent Injunction against defendant Fehn. In *S.E.C. v. Murphy*, 626 F.2d 633 (9th Cir. 1980) the Ninth Circuit enumerated certain factors that the Court must weigh in deciding whether to issue an injunction. Among those factors are the age of the defendant; his lack of recognition that his conduct was wrong, his professional occupation and whether he is likely to violate the securities laws in the future.

Mr. Fehn, is sixty years old and has been practicing specializing in the Securities field for approximately twenty-five years. He was certainly cognizant of the fact that the purpose of the Securities Acts is to "protect investors by promoting full disclosure of information thought necessary to informed investment decisions": *S.E.C. v. Ralston Purina Co.*, 346 U.S. 119, 124 (1953). The Court in *S.E.C. v. Murphy*, 626 F.2d 633, 642 (9th Cir. 1980) explained that the Acts constitute a comprehensive plan to insure that investors are protected by requiring the filing of Registration Statements containing material facts bearing upon the investment merit of publicly offered securities. The most material information are facts concerning the issuers.

Fehn knew at the time the securities were being publicly traded that the investors had not been alerted by the Registration Statements that CTI was a shell corporation, that it was Bud wheeler's deal to the extent that Wheeler organized it, acted as its Board of Directors, stripped the warrants from the stock and resold the stock alone and had

converted to himself a major portion of the proceeds of the IPO. All of this would have been material information to the investing public.

When Fehn had the opportunity to make this information public in the March 31, 1988 10-Q report he failed to do so because Wheeler did not want any disclosure made. As the Court observed in *S.E.C. v. Frank*, 388 F.2d 486, 488 (2nd Cir. 1968); A lawyer, no more than others, can escape liability for fraud by closing his eyes to what he saw and could readily understand. Or as the District Court for the District of Columbia held:

> Lawyers are not free to ignore the commercial substance of a transaction which could obviously be misleading to stockholders and the investing public.... [T]his Court rejects the proposition that a member of the bar can seek refuge behind a legal technicality, elevating form over substance, when he is a party to and fully familiar with the circumstances which indicate that illusory transactions are being undertaken which could be utilized to mislead third parties. (The attorney's] focus on the narrow legal question on which he opined in unrealistic in view of his participation in the total transaction which obviously had the possibility for misleading outsiders.

S.E.C. v. National Student Marketing Group, 402 F. Supp. 641, 647-8 (D.D.C. 1975).

As applied to the instant case, Fehn with knowledge of CTI's violation of the securities law gave comfort to the wrong doer, Wheeler, by advising him and the corporation of a right to silence where disclosure was legally mandated. What is more troubling is that Fehn's legal opinion had no basis in fact or law. This Court considers Fehn's actions in this case to be a most serious transgression for a practitioner in the securities field because it lends the imprimatur of

legality to corporate misfeasance which strikes at the heart of the regulatory system — open disclosure.

The defendant stated in his testimony and his declaration previously filed in this action[11] that it was his opinion at the time the 10-Q filings were made and it is his opinion now that the CTI periodic reports did not omit any material facts that were required to be disclosed.

After considering the totality of the evidence discussed above, this Court is of the opinion that there is a reasonable likelihood of future violations of the Federal Securities laws by the defendant Fehn. *S.E.C. v. Murphy*, 626 F.2d at 655; *S.E.C. v. Research Automation Corp.*, 585 F.2d 31, 36 (2d Cir. 1978).

INJUNCTION ORDER

I.

IT IS THEREFORE ORDERED, ADJUDGED AND DECREED that Defendant Fehn, his agents, servants, employees, and those persons in active concert or participation with him, who receive actual notice of this Final Judgment by personal service or otherwise, and each of them be and hereby are permanently restrained and enjoined from, directly or indirectly, in the offer or sale of any security, by the use of any means or instruments of transportation or communication interstate commerce or by use of the mails:

(1) employing any device, scheme or artifice to defraud;

(2) obtaining money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the state-

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[11] Docket #31.

ments made, in light of the circumstances under which they were made, not misleading; or

(3) engaging in any transaction, practice or course of business which operates or would operate as a fraud or deceit upon the purchasers of such securities.

II.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that defendant Fehn, his agents, servants, employees, and those persons in active concert or participation with him, who receive actual notice of this Final Judgment by personal service or otherwise, and each of them be and hereby are permanently restrained and enjoined from, directly or indirectly, in connection with the purchase or sale of any security, by the use of any means or instrumentality of interstate commerce or of the mails or of any facility of any national securities exchange:

(1) employing any device, scheme or artifice to defraud;

(2) making any untrue statement of material fact or omitting to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or

(3) engaging in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person.

III.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that Defendant Fehn, his agents, servants, employees, and those persons in active concert or participation with him, who receive actual notice of this order by personal service or otherwise, and each of them, be and are hereby

permanently restrained and enjoined from, directly or indirectly, failing or causing a failure to file with the Commission on behalf of any issuer whose Registration Statement has become effective pursuant to the Securities Act of 1933 in accordance with such rules and regulations that the Commission may prescribe as necessary and appropriate in the public interest or for the protection of investors, such supplementary and periodic information, documents, and reports as may be required, in a timely manner and in proper form, pursuant to Sections 13 and 15 of the Securities Exchange Act of 1934 [15 U.S.C. 78m and 78o] and the rules and regulations promulgated thereunder including, but not limited to: annual, quarterly and current reports on Forms 10-K, 10-Q, and 8-K in accordance with instructions on such forms, and such further material information, if any, as may be necessary to make the required statement, in light of the circumstances under which they were made, not misleading; provided, however, that nothing above shall apply to any issuer for which the duty to file such reports has been suspended or excepted pursuant to the provisions of the Securities Exchange Act of 1934.

IV.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that the Court shall retain jurisdiction of this matter for all proposes.

This Court makes an express determination that there is no just reason for delay and the Clerk of the Court is hereby directed to enter this Final Judgment.

IT IS SO ORDERED, dated April 1, 1994

/s/ MARY JOHNSON LOWE

Mary Johnson Lowe
Senior United States District Court

Exhibit 1, rulings on evidence made at trial.